

# Minnesota

## Department of Finance

October 2005

### Corporate Tax Receipts, One Time Items Lift State Revenues Above Forecast

Net non-dedicated general fund revenues totaled \$3.444 billion during the first quarter of fiscal 2006, \$282 million (8.9) percent more than end-of-session estimates. Receipts from each of the four major revenue sources exceeded the forecast with corporate income tax receipts \$93 million more than projected. Other revenues exceeded the forecast by \$137 million. Total receipts were 14.5 percent more than in the first quarter of fiscal 2005.

#### Summary of Tax Receipts: (July – September, 2005)

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	----- (\$ in millions) -----			
Income	1,571	1,581	10	0.6
Sales	929	963	34	3.7
Corporate	196	290	93	47.6
Motor Vehicles	68	75	7	10.1
Other	<u>398</u>	<u>535</u>	<u>137</u>	<u>34.5</u>
Total	3,162	3,444	282	8.9

Quarterly corporate estimated tax payments were \$91 million above forecast. (See page 4) Corporate tax managers appear to have increased estimated tax payments in the most recent quarter to reflect a stronger outlook for corporate profits. Corporate estimated payments for the most recent quarter were 16 percent above those in the prior quarter, and 38 percent above those a year ago. The positive variance in other revenues is largely attributable to estate tax receipts where a large return helped produce a positive variance of \$117 million. Estate tax receipts during the first quarter of fiscal 2006 exceeded the total amount of estate taxes revenue collected in fiscal 2005. Withholding tax receipts remained very close to forecast, up \$1.8 million from February's forecast. Gross sales tax receipts were \$22 million above end-of-session estimates.

Net non-dedicated general fund revenues for fiscal year 2005 are now reported to be \$298 million above forecast, \$11 million more than reported in July's *Economic Update*. Revised estimates of departmental earnings accounted for more than \$8 million of the additional revenue.

**Aftermath of Katrina and Rita Will Slow U.S. Economic Growth -- for a While**

Natural disasters usually have only a minor impact on the national economic outlook. Storms and earthquakes create a temporary disruption in local business activity, and there is a need to replace damaged or destroyed equipment, structures, and public infrastructure. But, most affected firms are quick to restart their operations and the repair and reconstruction efforts required to return to normal operation typically provide a modest short-term boost to the local economy. For those living outside the directly affected area disasters are topics for conversation, but not something that causes meaningful changes in household spending patterns or business production decisions.

Hurricanes Katrina and Rita were different. They were mega storms, significantly more destructive than most hurricanes. Indeed, Katrina was the costliest storm ever to hit the United States. But, from a national economic perspective the dollar amount of damage is secondary. What is really important is what was damaged. The twin storms' paths through the rich oil and natural gas producing areas off shore in the Gulf created a potential energy shortage. That supply problem has driven oil, gasoline, and natural gas prices substantially higher for everyone in the nation. Those higher energy prices do have the power to change consumer's spending patterns and slow the economy.

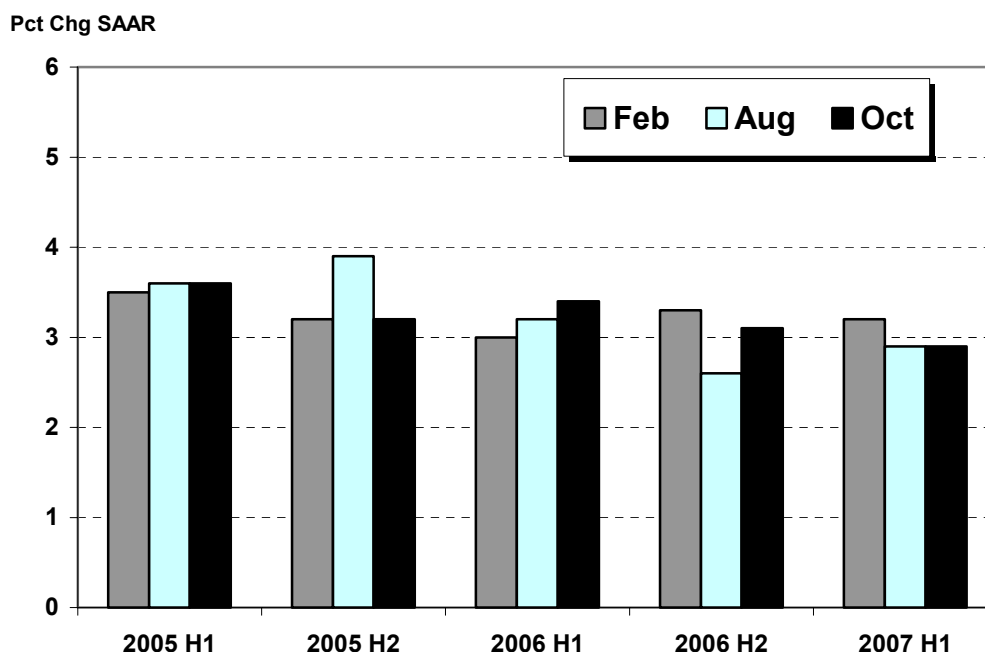
Forecasters are struggling to assess the impact of the twin storms on the economic outlook for the remainder of 2005 and early 2006, but that is not an easy task. The extent of the damage to the Gulf's energy production infrastructure is still largely unknown, and there are no good estimates of when refining capacity and natural gas production will return to their pre-storm levels. Much of the region's oil and natural gas production remains shut in and four major refineries damaged by Katrina remain closed.

Economists know their forecasts will need to reflect the cutbacks in household spending brought on by higher energy prices, but their projections will be surrounded with uncertainty until better information is available about where energy prices are likely to settle once they begin to trend down. Short-term forecasters face an additional challenge over the next few months as they try to assess whether visible signs of weakness in the national economic statistics reflect only local conditions in storm damaged New Orleans and along the Gulf Coast or whether they are the first signs of a broader national problem.

Like most forecasters Minnesota's national economic consultant Global Insight Inc., (GII), had grown increasingly optimistic about the economic outlook this spring and summer. Their August baseline called for real GDP growth rates near four percent in the second half of 2005. Once the damage from Katrina was apparent those estimates were cut back substantially. In Rita's wake GII's projections for the second half of 2005 were scaled back further to 3.2 percent. At the same time though GII's outlook for real GDP growth in both the first and second half of 2006 was increased. At present they believe the stimulus from the substantial amounts of promised federal spending coupled with a gradual return to normal business operations in the Gulf areas hardest hit by the storm

will more than offset reductions in economic activity elsewhere in the nation caused by higher energy prices and higher interest rates.

## Storms Change Short-term Economic Growth Path – Long-term GDP Outlook Unchanged



Even after incorporating the economic drag caused by the two hurricanes GII's October baseline calls for real GDP growth rates in fiscal 2006 and fiscal 2007 that are slightly stronger than those in their February baseline. GII now expects real GDP to grow at a 3.4 percent annual rate in fiscal 2006 and a 3.1 percent rate in the 2007 fiscal year. February's baseline anticipated real GDP growth at a 3.2 percent annual rate in both fiscal 2006 and 2007. October's baseline ends fiscal 2007 at nearly the same level of real GDP as was projected in February. The GII October baseline is the same as the Blue Chip Consensus forecasts for calendar 2005 and calendar 2006.

Inflation has become more of a concern as higher energy prices begin to work through the rest of the economy. GII expects the CPI to grow at about a 5 percent annual rate in the third and fourth quarter, then slow as energy prices fall. In calendar 2005 the CPI is now projected to grow at a 3.5 percent annual rate, followed by growth of 2.7 percent in 2006 and 1.4 percent in 2007. The outlook for core inflation, CPI less food and energy, holds at 2.5 percent for 2006 and 2007 indicating that GII believes firms now have the pricing power to begin passing along some of their additional costs to consumers.

Global Insight assigns a probability of 55 percent to their October baseline. A more pessimistic scenario which has slower growth but no recession is now assigned a 25 percent probability, up 5 percent from February. As in February a more optimistic scenario is given a 20 percent probability.

## Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	2005 Fiscal Year			July - September 2005		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<b><u>Individual Income Tax</u></b>						
Withholding	5,242,483	5,228,168	-14,315	1,299,411	1,301,225	1,815
Declarations	1,159,247	1,218,390	59,143	244,688	252,519	7,832
Miscellaneous	657,171	812,818	155,647	58,070	61,523	3,453
Gross	7,058,900	7,259,376	200,476	1,602,168	1,615,268	13,099
Refund	883,045	918,212	35,167	31,185	34,012	2,827
Net	6,175,855	6,341,164	165,309	1,570,984	1,581,255	10,272
<b><u>Corporate &amp; Bank Excise</u></b>						
Declarations	790,100	824,581	34,481	175,800	266,748	90,948
Miscellaneous	155,000	172,758	17,758	31,477	31,780	304
Gross	945,100	997,338	52,238	207,277	298,528	91,252
Refund	116,200	71,465	-44,736	11,000	8,896	-2,104
Net	828,900	925,874	96,974	196,277	289,633	93,356
<b><u>Sales Tax</u></b>						
Gross	4,476,300	4,486,449	10,148	980,620	1,002,264	21,644
Refunds	250,313	247,475	-2,838	51,553	39,268	-12,285
Net	4,225,987	4,238,974	12,986	929,067	962,996	33,929
<b><u>Motor Vehicle Sales</u></b>						
	262,700	258,964	-3,737	67,525	74,375	6,850
<b><u>Other Revenues:</u></b>						
Inherit/Gift/Estate	82,000	72,699	-9,301	21,500	138,525	117,025
Liquor/Wine/Beer	66,315	69,742	3,427	14,262	14,407	145
Cigarette/Tobacco/Cont Sub	149,030	147,776	-1,254	45,211	49,408	4,198
Deed and Mortgage	274,400	287,146	12,746	52,537	68,471	15,933
Insurance Gross Earnings	277,000	265,527	-11,473	61,700	65,103	3,403
Lawful Gambling	59,760	59,285	-476	12,524	10,040	-2,484
Health Care Surcharge	204,303	202,126	-2,176	49,921	51,218	1,297
Other Taxes	3,671	6,812	3,141	241	233	-9
state wide property tax	617,774	610,874	-6,900	90	290	200
dhs rtc Collections	42,220	50,420	8,200	12,767	12,907	140
Income Tax Reciprocity	49,850	49,850	0	0	0	0
Investment Income	14,600	20,112	5,512	3,750	9,095	5,345
Tobacco Settlement	175,388	175,488	100	0	0	0
Departmental Earnings	237,000	245,108	8,108	78,696	83,909	5,214
Fines and Surcharges	80,000	85,468	5,468	21,676	17,555	-4,121
Lottery Revenues	48,708	51,954	3,246	6,975	5,703	-1,271
Revenues yet to be allocated	0	3	3	0	1,173	1,173
Residual revenues	68,772	77,260	8,488	14,477	7,670	-6,807
Sales Tax Rebates (all years)	2	0	-1	0	-3	-3
County Nursing Home Pub Hosp	50,056	52,639	2,583	7,698	3,698	-4,000
Other Subtotal	2,500,848	2,530,290	29,441	404,025	539,402	135,377
Other Refunds	41,930	45,134	3,203	5,826	3,979	-1,847
Other Net	2,458,918	2,485,156	26,238	398,199	535,423	137,224
<b>Total Gross</b>	<b>15,243,849</b>	<b>15,532,416</b>	<b>288,567</b>	<b>3,261,615</b>	<b>3,529,836</b>	<b>268,221</b>
<b>Total Refunds</b>	<b>1,291,488</b>	<b>1,282,285</b>	<b>-9,203</b>	<b>99,564</b>	<b>86,155</b>	<b>-13,409</b>
<b>Total Net</b>	<b>13,952,361</b>	<b>14,250,131</b>	<b>297,771</b>	<b>3,162,051</b>	<b>3,443,682</b>	<b>281,631</b>